

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :
of :
METRO GROCERY & DELI, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1985 :
through August 31, 1988. :

In the Matter of the Petition :
of :
KIE SEO AHN, OFFICER OF :
METRO GROCERY & DELI, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1985 :
through August 31, 1988. :

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DETERMINATION
DTA NOS. 809321,
809322, 809323,
809324 AND

In the Matter of the Petition :
of :
GI CHEUL KIM, OFFICER OF :
METRO GROCERY & DELI, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1985 :
through August 31, 1988. :

In the Matter of the Petition :
of :
HEE YONG KIM, OFFICER OF :
METRO GROCERY & DELI, INC. :
for Revision of a Determination or for Refund :
of Sales and Use Taxes under Articles 28 and 29 :
of the Tax Law for the Period September 1, 1985 :
through August 31, 1988. :

In the Matter of the Petition	:
	:
of	:
	:
JAE KWON LEE, OFFICER OF	:
METRO GROCERY & DELI, INC.	:
	:
for Revision of a Determination or for Refund	:
of Sales and Use Taxes under Articles 28 and 29	:
of the Tax Law for the Period September 1, 1985	:
through August 31, 1988.	:

Petitioners, Metro Grocery & Deli, Inc. and Kie Seo Ahn, Gi Cheul Kim, Hee Yong Kim and Jae Kwon Lee, as officers of Metro Grocery & Deli, Inc., 461 Seventh Avenue, New York, New York 10001, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period September 1, 1985 through August 31, 1988.

A consolidated hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on August 6, 1992 at 11:30 A.M., and continued to its conclusion on October 14, 1992 at 10:30 A.M., with all briefs to be submitted by April 26, 1993. Subsequently, at the request of petitioners' representative, the due date for all briefs was extended by one month. Petitioners, by their representative Abraham & Silver (Herbert J. Silver, Esq., of counsel), filed their brief on February 26, 1993. Subsequently, the Division of Taxation requested a 30-day extension for the filing of its brief, which was granted by the Administrative Law Judge. Thus, all briefs were to be submitted by June 25, 1993. The Division of Taxation, appearing by William F. Collins, Esq. (Robert J. Jarvis, Esq., of counsel), submitted no brief.

ISSUES

I. Whether a motion for default made by the Division of Taxation should be granted as to the appearance of one officer of Metro Grocery & Deli, Inc. due to his death after the commencement of the hearing and before the conclusion of the same.

II. Whether the Division of Taxation properly determined additional sales and use taxes due

from Metro Grocery & Deli, Inc.

III. Whether penalties and interest assessed against petitioners should be abated for reasonable cause.

FINDINGS OF FACT

The Division of Taxation ("Division") issued 10 notices of determination and demands for payment of sales and use taxes due for the period September 1, 1985 through August 31, 1988 dated September 1, 1989 following a field audit. Five of these notices issued to Metro Grocery & Deli, Inc. ("Metro") and Kie Seo Ahn, Gi Cheul Kim, Hee Yong Kim and Jae Kwon Lee each assessed tax due for the noted period in the amount of \$231,138.68, plus penalty and interest, for a total amount due of \$372,360.93. The other five notices assessed an additional "omnibus" penalty (Tax Law § 1145[a][1][vi]) for the same period in the amount of \$23,113.84 against each of the petitioners. The record reveals that validated consents extending the statute of limitations on the assessments had been executed such that the timeliness of the notices of determination described herein is not at issue.

The sales and use tax as assessed is comprised of two major components: a use tax deficiency of \$111.38 on fixtures and equipment and a sales tax deficiency in the amount of \$231,027.34. The use tax deficiency is not in issue in this matter. Additionally, the status of the personal liability of the four individual petitioners as officers is not in question.

Petitioner Metro is a New York corporation organized for the purpose of operating a retail grocery and deli located at 461 Seventh Avenue, New York, New York. Its Manhattan location is at the corner of 35th Street and Seventh Avenue adjacent to Macy's Department Store.

Metro has been in operation since June 9, 1985 at the same location. Initially, the business consisted primarily of the sale of fresh fruits and vegetables as well as certain grocery items. Approximately one year after Metro began business, a cold salad bar consisting of cut-up fruits and vegetables was added. Subsequently, about a year and one-half after the store was opened and as a result of customer requests, the salad bar was expanded to include the sale of

certain hot food items. One of the petitioners, Jae Kwon Lee, testified as to the evolution of the salad bar and its pricing. When the salad bar began, Metro charged \$1.99 per pound for such food items. In March 1987, the price was raised to \$2.29 per pound. Again, in September 1987, the price was raised to \$2.79 per pound. In February 1988, the price accelerated to \$2.99 per pound and, in December 1988, Metro charged \$3.49 per pound. The testimony of Mr. Lee further revealed that petitioners did not sell beer during the first six months of business operations.

Petitioners submitted into evidence four small signs indicating the price per pound of salad bar items. Testimony was provided on behalf of petitioners that these signs had been used to notify customers of the price per pound for the purchase of items from the salad bar and to support their position that the salad bar had increased its prices over some period of time. Although the signs do not indicate the time frame during which they were used in the business, their informational content corresponds with the testimony and they do appear to be authentic in that they have an aged appearance.

The assessments in this matter were issued after a field audit of Metro's business operations. Several times prior to and during the field audit, the Division corresponded with the business for the purpose of requesting books and records. On May 5, 1988, the Division issued to Metro an appointment letter indicating that Metro's sales tax returns for the period June 1, 1985 through February 28, 1988 would be subject to a field examination and that petitioners were expected to produce all books and records pertaining to the sales tax liability of Metro, including journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all other records pertaining to sales tax. A subsequent letter, dated June 23, 1988, indicated an appointment date of July 7, 1988 and listed the audit period again as June 1, 1985 through February 28, 1988. This second appointment letter provided the same specifics as to the records the Division would expect petitioners to have available for examination. A third letter to Metro issued by the Division, dated April 5, 1989, requested "all records pertaining to sales in order to update the audit to quarter ended 8/31/88." It included a request for sales per

general ledger, bank statements, daybook, purchases and any other records pertaining to Metro's sales tax liability.

The appointment date noted in the correspondence of June 23, 1988 was rescheduled for July 18, 1988 whereby the Division examined certain available records at the office of Wolk and Lawlor, petitioners' representatives. The auditor's tax field audit record indicated that on such date the "accountant suggested that we do an observation. [H]e said we will not be able to read daybook, as it is in Korean. Left list of records needed."

The records available during audit included the Federal and State income tax returns, an incomplete check disbursements journal, a general ledger and incomplete monthly bank statements. The auditor had additionally requested the original daybook and cash register tapes for the period September 1, 1985 through May 22, 1988.

With respect to the records maintained by Metro, Mr. Lee testified that in the early years of the business operations all of the partners took an active role in the daily business activity and each night one of the partners would return to the store and work that night to manage the store along with the manager. Mr. Lee testified that the manager was the person who recorded the figures maintained on petitioners' Exhibits "7" through "10" which represent gross daily sales and current daily expenditures. He stated that these were the documents kept in the ordinary course of business and were ultimately provided to the accountant for preparation of more formal records. Mr. Lee testified that the daily records of sales were recorded from the information obtained from the cash register and expenditure invoices. The documents submitted were a simplified form of a cash receipts and disbursements journal with little detail. When Mr. Lee was questioned with regard to why register tapes were not kept or what advice petitioners had received with regard to maintaining cash register tapes, he indicated that at the inception of the business it was necessary to rely on counting the actual money because the cashiers were too inexperienced to be relied upon, and therefore the tapes themselves were not reliable. When they explained the difficulty they had with regard to inexperienced cashiers to the accountant, their accountant at that time told them to keep a record of daily sales and submit

such information to him for purposes of preparing certain reports. In fact, the auditor's field audit report notes that the Federal and State tax returns filed by petitioners for the tax periods in issue were in substantial agreement with the information contained in Metro's books and records.

The gross sales column on the records of daily sales, submitted to Metro's accountant for his preparation of appropriate tax returns and reports, included both taxable and nontaxable items. Mr. Lee was asked how the accountant would compute the sales tax liability if such a breakdown was not provided. He responded that the accountant would come into the deli, check the items that were sold there, and determine generally what percentage of merchandise was taxable and which was nontaxable.

Since Metro's records were recorded in Korean, the cash register receipts were not maintained, the purchase invoices were not available, and the monthly bank statements and the cash disbursements journal were incomplete, the Division determined that petitioners did not maintain books and records sufficient to conduct a detailed audit. The Division discussed these facts with petitioners' representative and it was agreed that an observation of petitioners' business would be done.

The auditor's field audit record revealed that on August 12, 1988 she contacted petitioners' representative, Robert Wolk, and informed him that, sometime between August 22 and September 2, an observation test of the business operations would be done to estimate petitioners' sales tax liability for the period in question. Before an actual observation test took place, numerous attempts were made by the auditor to set up meetings with petitioners' representative, as well as to acquire such records as the cash register tapes and Metro's daybook. The Division was informed that petitioners' representative would be unavailable in early December and, on December 7, 1988, the Division informed petitioners' representative that the observation would be conducted on December 14, 1988.

The observation test of December 14, 1988 included numerous auditors to monitor the sales of four cash registers between the hours of approximately 7:00 A.M. and 2:30 P.M.

During a portion of that time, the Division noted certain key facts which ultimately formed the basis of its decision to abandon the observation test scheduled that day. The Division noted the following facts:

"Candy and gum trays were low at 10 [o'clock] and never refilled. Hot food was not put out until 11:30 [A.M.] and there were between 3 and 4 unused hot trays the entire time. The filled hot trays were not readily replenished. Several (at least 4 seen by me) put back their plastic containers, saying that there wasn't 'anything good' here and 'where was the regular food?' At least 15 [to] 18 people were heard by me to say comments such as 'where's the turkey' or 'chicken', lasagna, 'where's the regular food', 'will the kitchen be back to normal tomorrow?', 'I wonder if they're going out of business?'"

The auditor further observed that certain salads were not being weighed, though the pricing was imposed on a per pound basis. In addition, the full price of certain items was not recorded. The auditor further noted that "at 12:15 the team leader was told, and the accountant told the manager to speak to her [the cashier]. [H]e did speak to her in Korean, but the same incidents continued."

A second page of observation notes were recorded by a second auditor on the premises on December 14, 1988. In pertinent part, the notes provided the following information:

"The trays on the hot plate were either partially or completely empty. When they were empty, there [sic] were not refilled. It was noted on several occasions that the clerk was not ringing up the entire sale. There was one instance when the clerk recorded a sale at \$4[.00] less than what the price should have been based on the weight of the tray's contents."

Prior to the first observation date, which was ultimately disregarded, the Division was informed that Metro did not keep cash register tapes before May 1988. However, beginning on May 25, 1988 and extending to August 17, 1988, Metro recorded total daily sales for each of the days in a 13-week period. The summary was taken from "z" tapes which are a summary of the totals of the sales for a day not providing any breakdown as to items sold, categories or the taxability of the sale. The auditor testified that the figures recorded as such daily sales from the tape readings were not utilized for the purpose of projecting sales for the audit period for two reasons: they were presented to the auditor well after the commencement of the audit (after petitioners had been given many opportunities to present proper records) and even more importantly, because the tape readings did not even reasonably coincide with amounts that were

recorded pursuant to the observation test. In fact, the daily observed sales were more than 150% of the average Wednesday sales as evidenced by the tape readings.

During January 1989, petitioners' representatives met with the Division. The Division introduced into evidence notes from the meeting of January 26, 1989 which indicated that since Mr. Wolk was going to be away, the second observation test would not be conducted during February 1989. The notes additionally reveal the following: "Representatives agreed that next observation day will be conducted as a regular business day, with their normal variety of food [and] that trays would be replenished as needed." Subsequent to that time, a second observation date was chosen. On March 2, 1989, petitioners' representatives were informed that an observation test would be performed the week of March 20, 1989. A week later, petitioners' representatives were informed the observation would be conducted on March 22, 1989 and thereafter such testing was performed on that date.

The auditor again recorded certain notes from her observation. The auditor indicated that the observation of four cash registers in use at various times during the day began at 7:15 A.M. and continued to 7:00 P.M. Subsequently, on June 12, 1989, a conference was held between petitioners' representatives and the Division. Notes of such meeting reveal that the representatives took the position that the observation in March on the Wednesday before Easter was not representative of Metro's business. In addition, major renovations were done on Metro's business premises affecting the volume of business in January 1989.

The results of the observation test performed on March 22, 1989 (a Wednesday) resulted in gross sales for the day of \$4,645.00. As previously described, petitioners made available for the period May 23, 1988 through August 21, 1988 certain summaries of cash register tapes ("z tapes") from which the auditor determined that the portion of Metro's sales attributable to Wednesdays comprise 17.26% of its sales for a week. (This was the only use made of such information by the auditor.) The auditor then divided \$4,645.00 by 17.26% to calculate weekly gross sales and multiplied the result by 13 weeks to obtain quarterly gross sales of \$349,855.00. This amount was projected to each of the sales tax quarters in the audit period by adjusting it for

an inflation factor of 5% per year, resulting in gross sales for the audit period of \$3,906,236.00. Taxable sales for the audit period were then computed by multiplying this gross sales figure by Metro's observed taxable ratio of 81.8%¹ resulting in audited taxable sales

of \$3,195,301.00. The audited taxable sales were multiplied by the tax rate for the period, 8.25%, resulting in audited tax due in the amount of \$263,612.34, from which the tax paid per the sales tax returns (\$32,585.00) was subtracted. The resulting amount of \$231,027.34 is the amount of the sales tax deficiency contested herein.

In connection with her calculations, the auditor was questioned about whether she performed any other comparative calculations of the proposed tax deficiency. She indicated by her testimony that she used several other external indices to project the tax due, such as officer's salaries, interest, and the price paid for the business. The workpaper submitted into evidence that indicates such calculations were performed states that the auditor used Metro's Federal return and Dun & Bradstreet Corp.'s "Cost of Doing Business" factors for officers salaries, interest and depreciation. In all three computations, the factors were applied to amounts obtained from Metro's tax returns to arrive at a gross sales figure, which was subsequently multiplied by the observed taxable ratio and the tax rate. In each case, the audited tax due exceeded the amount assessed to petitioners by \$59,000.00 to \$231,000.00. It is somewhat unclear from the testimony at what point the auditor made such calculations and the audit workpaper did not bear a preparation date, as do most others. However, she clearly stated that the comparative computations were "made to verify what I had already calculated" (Tr., p. 190).

The auditor was also questioned about whether she considered the facts that no salad bar existed during the early portion of the audit period and no beer was sold for the first several

¹In accordance with the field audit report, the auditor noted that during the observation on March 22, 1989 nontaxable sales were recorded and found to be at 18.2% of gross sales, thus resulting in 81.8% as the taxable percentage.

months of the audit period. The auditor indicated that such information could have altered her calculation or the method of observing Metro's sales, if she had been made aware of such facts. The record is clear that the auditor had not been given such information from both her testimony and the manner in which petitioners' representative stated, "We will show there was no salad bar for a period of time of the audit period and I am asking the auditor if she had known that fact would that have made a difference in the calculation." Petitioners attributed the auditor's lack of awareness of such information to her failure to inquire about the history of Metro's business operations. Although the auditor indicated that she customarily makes such inquiry, she did not have any recollection as to whether she did so in this case, or what type of inquiry she may have made.

As previously mentioned, the auditor adjusted the audited tax due by a 5% inflation factor for each of the three years covering the audit period. When questioned as to the basis of the 5% factor, the auditor stated that it was an estimate which she subsequently verified with the U.S. Labor Department. Introduced into evidence by the Division was a workpaper prepared by the auditor which evidenced a telephone call to the Labor Department to obtain the annual average Consumer Price Index. The auditor's notes recorded consumer price indices and from such information, she computed "inflation factors" of 3.6% from 1985 to 1986 and 5.7% for each of the two years from 1986 to 1987 and 1987 to 1988. Given the indices recorded from the telephone conversation, the results should have reflected price percentage changes of 3.3%, 5.1% and 4.83% for the 1985-86, 1986-87 and 1987-88 years, respectively. In an attempt to challenge the Division's use of the estimated 5% inflation factor, petitioners introduced into evidence an excerpt from the U.S. Labor Department's compilation of Consumer Price Index statistics. The expenditure category of food and beverages for Urban Wage Earners and Clerical Workers in the New York City geographic location indicated a percentage change in the index for the period from April 1986 to February 1987 of 5.5%. The food and beverage category was further divided into several component parts, including food at home, food away from home and alcoholic beverages, each with their own percentage change, some above and

some below the 5.5%.

The auditor was additionally questioned regarding her observations of the change in the physical appearance of the deli. The auditor testified that she had noticed a difference in the appearance of the store between the first scheduled observation date of December 14, 1988 and the actual date of the observation test, March 22, 1989. She was aware that the salad bar had been enlarged providing four additional food bins, and that a new staircase existed.

Petitioners provided the testimony of Robert Wolk, a public accountant who retired from New York State service after 27 years with the State in the area of sales tax, beginning his career with the New York City Department of Finance in 1956. Since his retirement, he became engaged in tax consulting. When asked whether he had had an opportunity to evaluate the results of the audit conducted in this matter, and whether he had any opinion as to the methods used by the auditor, he voiced his opinion that the auditor conducted an inadequate investigation of the history of the business, and that such failure distorted the entire audit. Mr. Wolk testified that the daily records were made available to the auditor and claimed that the auditor and the team leader ignored the records because they were recorded primarily in Korean. When questioned whether his schedule conflicted with proposed choices for the observation test date prior to March, which contributed in part to the choice of March 22 as a test date, with which he now takes issue, he stated that he was not aware of such conflict and petitioners' representatives were given no choice regarding the date chosen. Later testimony revealed he was on vacation during January and February 1989. Mr. Wolk characterized the audit as unfair for the following reasons:

- (1) The observation date was within a busier than usual holiday shopping week, as it was the week prior to Easter, and the location of Metro (near Macy's) is directly affected by such activity; and
- (2) The price differences between the observation test date and the beginning of the audit period were not considered; and
- (3) Since Metro's records were adequate, they should have been used.

A document prepared by a member of Mr. Wolk's firm was introduced into evidence for the purpose of challenging the 5% inflation factor applied to the audit computations. It was a comparison between 1985 and 1989 prices corresponding to the purchase of food items sold on the premises. The information used in the preparation was extracted from Metro's purchase invoices during those years, according to the testimony of Mr. Wolk and his partner Joseph Lawlor. In each of the years examined, one invoice showing the price of each item listed was reviewed for the pricing information. No invoices were submitted as part of the record. The price differential and the individual percentage increase in the prices paid for 27 items were calculated. The result was an average cumulative (1985-1989) 55% increase in cost. Mr. Wolk stated that this figure should be used in place of the Division's 15% (total) inflation allowance.

Petitioners further provided the testimony of Paul Carucci, an accountant who joined the New York State Tax Department in 1963, and whose sales tax experience stems back to 1965. Presently, Mr. Carucci maintains a sales tax consulting firm. At petitioners' request, Mr. Carucci conducted and supervised his own audit of Metro on February 4, 1992, a Wednesday. His testimony revealed an observation test of Metro, between the hours of 8:00 A.M. and 4:00 P.M. One person kept track of sales made from the front register and another monitored the side register. They recorded the nontaxable sales for the day, listing the items as they were sold. He testified that he called the store the following day and requested "the totals from the tapes". He was told the total sales recorded for February 4, 1992 were \$2,434.00, with \$572.30 as nontaxable sales. Thus, the taxable and nontaxable ratios resulting from the sales on that date were 76.5% and 23.5%, respectively. Mr. Carucci also expressed that in his opinion, the methods employed in the assessment by the auditor in this case were unfair and unreasonable for many of the same reasons stated in Mr. Wolk's testimony.

A conciliation conference was held in this matter on October 4, 1990 and, by a Conciliation Order dated December 28, 1990, the statutory notices were sustained.

SUMMARY OF THE PARTIES' POSITIONS

Petitioners argue that the auditor completely disregarded the system of recordkeeping

employed by Metro in reaching the determination of the alleged tax deficiency.

In addition, petitioners submit that the observation test conducted by the Division did not fairly and accurately represent the business for the following reasons:

(a) Since the business is located immediately adjacent to Macy's and the chosen audit date is one of the busiest shopping days of the year, it is not representative of other general business days.

(b) The volume of business on the observation date would not have been representative for the entire period of the assessment since Metro was a start-up business beginning in June of 1985 and the grocery/deli/salad bar concept was not in place at the commencement of the business and certainly did not meet the same volume of the company's sales that would be representative in March 1989.

(c) The company had renovated the business premises in January 1989, which would have contributed to an increased amount of business unrepresentative of the audit period.

(d) A test audit in the spring of 1989 would not be representative of the ordinary calendar year since the company's sales from the salad bar, which petitioners assert constitutes a major component of the company's taxable business, begins to build in the spring and reaches its highest point in the summer, with the period from November through February showing a substantially lower volume due to the weather.

(e) Petitioners further assert that the assessment fails to take into account the increase in the salad bar sales price per pound.

The Division asserts that its resort to external indices, including specifically an observation test, was warranted given the absence of adequate records from which to conduct a detailed audit of petitioners' tax liability. The Division further alleges that petitioners' offer of evidence in an attempt to warrant certain reductions to the assessed amounts is inadequate or has already been taken into account by the auditor's calculations.

CONCLUSIONS OF LAW

A. Section 3000.10(b)(2) of the Tax Appeals Tribunal Rules of Practice and Procedure

states the following:

"In the event a party or the party's representative does not appear at a scheduled hearing and an adjournment has not been granted, the administrative law judge shall, on his or her own motion or on the motion of the other party, render a default determination against the party failing to appear."

The Division has made a motion for default due to the fact that one of the individual petitioners in this matter died after the commencement of the hearing and before it was recommenced on October 14, 1992, the day it was concluded. In this case, Kie Seo Ahn properly appeared by his representative at the commencement of the hearing. A default determination for non-appearance by such officer would be inappropriate.

While it may be technically correct that the power of attorney from Mr. Ahn was revoked upon his death, it was made clear on the first day of the hearing that his status as officer was not a contested issue. Thereafter, this petitioner along with the others, bearing the same representation, fully and fairly litigated the audit issues. Since the corporation was contesting audit issues and the only remaining issue that could have been raised by Mr. Ahn was not in question, no end is served by a bifurcation of this matter. No injustice results to the Division or to this petitioner. The case law has well established that an officer of a corporation bears derivative liability. Thus, whatever liability will be determined against the corporation in this matter will inure to each of the officers individually, notwithstanding Mr. Ahn's personal liability as originally assessed (Matter of Halperin v. Chu, 138 AD2d 915, 918, 526 NYS2d 660, 662, appeal dismissed in part, denied in part 72 NYS2d 938, 532 NYS2d 845).

B. The Tax Law, attendant regulations, and abundant case law developed in connection therewith leave it well settled that a vendor such as Metro is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (see, Tax Law §§ 1138[a], 1135, 1142.5; see, e.g., Matter of Mera Delicatessen, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained "shall include a true copy of each sales slip, invoice, receipt, statement or memorandum" (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, "the amount of

tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . ." (Tax Law § 1138[a]; see, Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 46, 411 NYS2d 41, 43).

When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (Matter of Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, cert denied 355 US 869); exactness is not required (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, lv denied 44 NY2d 645, 406 NYS2d 1025; Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (Matter of Meskouris Bros. v. Chu, 139 AD2d 813, 526 NYS2d 679; Matter of Surface Line Operators Fraternal Org. v. Tully, 85 AD2d 858, 446 NYS2d 451).

C. In this case, despite repeated requests for records over an extended period of time, petitioners maintained and made available only limited books and records which, in their entirety, were not adequate for purposes of conducting an audit to determine the accuracy of Metro's sales tax returns as filed. In particular, no guest checks or cash register tapes were available for the period in question. The daily sales records were not independently verifiable and no source documentation was maintained. It therefore follows that the Division was unable to conduct a complete audit and therefore was entitled to resort to indirect methods and estimates as a means of determining Metro's sales and calculating petitioners' sales and use tax liability. Utilization of estimates in arriving at petitioners' tax liability is even more justified when it is admitted that Metro's own sales tax returns were prepared by its accountant with an estimation of the nontaxable percentage of sales.

D. Petitioners' challenge to the subject assessments focuses essentially upon alleged errors in the auditor's method of calculation. More specifically, petitioners challenge whether the observation day was a day representative or typical of Metro's operations since the business

is located immediately adjacent to Macy's Department Store and the chosen observation date was several days before Easter of that year. In addition, petitioners challenge such day because the volume of business on the observation date did not adequately represent the entire period of the assessment since Metro was a start-up business beginning in June 1985. At that time the salad bar concept was not in place and the business's sales volume did not reach the same level as March 1989. Petitioners further allege that since the company had renovated its premises, which contributed to an increase in the volume of sales, the calculation should have considered this factor. Further, petitioners allege the calculation fails to take into account the increase in salad bar prices per pound over the course of the audit period.

E. It is clear that indirect audit methodologies may not always result in an exact determination of liability. However, it is equally clear that where a taxpayer's own failure to maintain adequate, accurate and complete books and records requires resort to such indirect audit techniques, exactness is not required of the Division in arriving at its determination and the consequences of recordkeeping failures in this regard weigh heavily against the taxpayer (Matter of Meskouris Bros. v. Chu, *supra*). With respect to the audit date chosen, petitioners had been given an initial opportunity in the latter part of 1988. The field audit report indicates that several attempts were made at acquiring Metro's available records as well as scheduling an observation date prior to December 14, 1988. When the observation was conducted on December 14, 1988, there is some indication that petitioners were less than accommodating during the observation test. There were customer comments recorded by the auditor which seem to indicate that petitioners were making some attempt to alter the results of the observation test by not conducting their business as usual and not recording sales in a customary business manner. When the first observation test was abandoned, conferences took place in order to reconvene the audit in this matter. The fact that the observation test was not rescheduled until March 22, 1989 does not appear to be a delay on the part of the Division but rather seems to have been partly driven by the schedule of petitioners' representatives. If, in fact, petitioners had some objection to such date, it should have been voiced at that time and

there is no record of any comments in that regard. As to the fact alleged by petitioners that the salad bar did not exist in the early part of the audit period, the Division's auditor testified that she was unaware of this fact. Petitioners' representative blamed the auditor for her failure to properly record the history of the business. Although the auditor may have in fact neglected to ask certain questions regarding the business operations, it is petitioners' duty to come forward with the information that petitioners feel would affect such liability since petitioners failed to keep adequate books and records. There is no little doubt that the volume of business on the observation date was probably not truly representative of the entire period of the assessment since Metro was a start-up business in the beginning of June 1985. Perhaps there is also some truth to the fact that certain items such as the salad bar were not being sold during the early part of the audit. However, petitioners' failure to maintain records leaves no support for these facts and, as previously stated, the Division is not required to perform an audit with any measure of exactness in arriving at its determination in such a case. Likewise, petitioners offered nothing to show what percentage of business the salad bar comprised such that an adjustment could be made for the change in pricing over the audit period. The salad bar signs indicating a price change appeared authentic and the testimony regarding such change in pricing was credible. However, petitioners' failure to keep records to show what portion of the observation should be adjusted leads to petitioners' failure to carry their burden of showing that the tax assessed was unreasonable. Although the company had renovated the premises in 1989 and perhaps in doing so their sales volume was positively affected, they knew an observation test was going to be performed at some point in 1989 since the December observation date had been abandoned, and they did not attempt to show by any detailed records what increase in sales took place in the post-renovation period.

Petitioners also take issue with the fact that the "z" tapes were not relied upon as representative of petitioners' business. First of all, these records were maintained only for the final quarter of the audit period. But more importantly, the "z" tapes were merely summary totals. They provided absolutely no detail as to the items recorded, they did not show taxable

versus nontaxable items, and they failed to show any separation of items into other sales categories. Thus, for the auditor to have relied upon the "z" tapes only for the purpose of determining what percentage of sales is represented by Wednesday was reasonable.

Additionally, petitioners take exception with the inflation allowance used as part of the calculation by the Division. The Division's use of an estimated 5% inflation factor was reasonable. There is no requirement that inflation be accounted for in a calculation such as this. If the Division can be faulted with regard to the use of an inflation factor, it is based on the fact that it was merely an estimate. However, in this particular case the estimate was subsequently verified with the U.S. Labor Department and the numerical statistics were reasonably close to the 5% estimate. In addition, petitioners' own submission of Consumer Price Index information verifies that an average annual food and beverage percentage change was slightly over the 5% even though individual categories of certain food items were slightly different. With regard to petitioners' submission of the 55% inflation allowance and the pricing comparison of food items between 1985 and 1989 there are numerous problems. First, no invoices were submitted into evidence to support the findings of Mr. Wolk. Secondly, and perhaps more importantly, the price that one pays for an item clearly reflects various factors in addition to inflation, such as a less than desirable business arrangement. If that were the case, the prices paid for certain individual items would have absolutely no correlation to the rate of inflation. In this case there is no reason to accept petitioners' factor of 55% in favor of the Division's factor of 15% for the three-year audit period.

F. The daily sales records of petitioners were primitive at best. Although recorded primarily in Korean, it was possible to discern the information recorded on such pages with some assistance. However, the information as recorded was not verifiable in any manner and, as such, could not be relied upon to conduct a detailed audit. The observation test in the audit of Metro will not be disturbed in this case. Though the Division's method clearly is not immune from criticism, petitioners have only demonstrated that the Division's tax calculation is imprecise and perhaps that it has not considered every nuance of change from the beginning of

the audit period to the end. Petitioners have not, however, met their more onerous obligation of proving, by clear and convincing evidence, that the result of the method used was unreasonably inaccurate or that the amount of the tax assessed is erroneous (Matter of Meskouris Bros. v. Chu, supra; Matter of Surface Line Operators Fraternal Org. v. Tully, supra).

G. Tax Law § 1145(a)(1)(vi) imposes the omnibus penalty and states, in pertinent part:

"Any person required by this article to file a return, who omits from the total amount of state and local sales and compensating use taxes required to be shown on a return an amount which is in excess of twenty-five percent of the amount of such taxes required to be shown on the return shall be subject to a penalty equal to ten percent of the amount of such omission If the tax commission determines that such omission was due to reasonable cause and not due to willful neglect, it shall remit all of such penalty."

Pursuant to the authority noted above, the omnibus penalty is imposed when it is determined that petitioners omitted an amount greater than 25% of the tax required to be shown on the sales tax return, unless petitioners carry the burden of proving that underreporting was due to reasonable cause and not willful neglect. Petitioners have failed to meet such burden. Petitioners assert, in part, that they relied upon a tax professional to assist them in the preparation of sales tax records. However, such reliance cannot replace the responsibility placed upon the owners of a business to have a basic understanding of the methods used to calculate such liability. Petitioner should have been aware, after numerous years in business, that the sales tax liability should not be based on an estimate. Additionally, petitioners allege ordinary business care and prudence. The president of Metro is a gentleman who came to the United States in 1977. He worked in another similar food store capacity for approximately eight years prior to beginning the business of Metro. If petitioners had the business acumen to sustain such an operation in a prime location of Manhattan, one can assume they should have known or can reasonably expect them to have made an inquiry regarding what records had to be maintained for such business to meet proper reporting guidelines. The fact that petitioners sought the advice and provided the testimony of professionals in the sales tax consulting field does not serve to support their assertion that they acted with ordinary business care and prudence with regard to the nonpayment of sales tax.

H. The petitions of Metro Grocery & Deli, Inc., and Kie Seo Ahn, Gi Cheul Kim, Hee Yong Kim and Jae Kwon Lee, as officers, are hereby denied and

the notices of determination and demands for payment of sales and use taxes due dated September 1, 1989 are sustained.

DATED: Troy, New York
December 23, 1993

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE